BEFORE THE ARIZONA CORPORATION CC

COMMISSIONERS

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF SOLARCITY CORPORATION FOR A DETERMINATION THAT WHEN IT PROVIDES SOLAR SERVICE TO ARIZONA SCHOOLS, GOVERNMENTS, AND NON-PROFIT ENTITIES IT IS NOT ACTING AS A PUBLIC SERVICE CORPORATION PURSUANT TO ART. 15, SECTION 2 OF THE ARIZONA CONSTITUTION.

DOCKET NO. E-20690A-09-0346

STAFF'S INITIAL CLOSING BRIEF

I. INTRODUCTION.

In this case, SolarCity Inc. ("SolarCity" or "Company") seeks a determination by the Arizona Corporation Commission ("Commission") that, when it provides electric service to schools, non-profit organizations, and governmental entities, it is not a public service corporation. The record in this case demonstrates that SolarCity's solar panels will generate electricity and that electricity will then be furnished to its customers. SolarCity will own, operate, and maintain each system.

To determine whether an entity is a public service corporation, Arizona courts employ a two-part test which looks at the plain language of the Arizona Constitution and then analyzes the provision of service using the *Serv-Yu* factors as guidance. SolarCity claims that it does not fall within Article 15, § 2 of the Arizona Constitution, which defines a public service corporation as an entity that furnishes gas, oil, or electricity for light, fuel, or power. SolarCity also argues that it does not meet the *Serv-Yu* factors. The Commission's Utilities Division Staff ("Staff"), however, has determined that SolarCity is acting as a public service corporation when it provides service to the entities at issue in this proceeding.

The Company argues that its contracts are primarily financing arrangements and thus are beyond the scope of the Commission's authority to regulate. As discussed in this brief, Staff's review of the contracts indicates that they primarily address the sale of electricity, and are not

primarily financing arrangements. Although the model used by the Company is now focused upon schools, non-profit organizations, and governmental entities, this may not always be the case. According to the Interstate Renewable Energy Council, nearly all of the larger installations and many medium-size non-residential installations use purchased power agreements, and at least one company now offers purchased power agreements for residential customers. In other words, the SSA or PPA model now employed by SolarCity is also used for for-profit corporations and in the future may be used for residential installations too.

Several parties argue that there is no need for regulation in this case because the market is competitive. The Commission, however, regulates the provision of competitive telecommunications services and does so in a streamlined manner. Staff recommends a streamlined form of regulation in this case, something that has been referred to as "regulation-lite". Based upon the record in this case, regulation-lite could consist of something as simple as registration (a streamlined CC&N), the filing of the SSAs or PPAs with the Commission, the filing of annual reports, and the ongoing availability of the Commission's complaint processes.

To conclude that the Commission does not have jurisdiction over providers such as SolarCity is not consistent with Arizona law. SolarCity is clearly acting as a public service corporation when it provides service pursuant to a PPA or SSA. In the future, the face of distributed generation may be much different, and the need to regulate may become much more critical. The Commission should resist the temptation to decline jurisdiction because of suggestions that regulation would be too costly or would not serve any purpose. Electricity is an essential commodity whether provided as part of a distributed generation model or as part of a more traditional model.

II. BACKGROUND.

On July 2, 2009, SolarCity Inc. ("SolarCity" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for a determination that it is not acting as a public service corporation when it provides electric service to Arizona schools, governments, and non-profit entities. Specifically, the application requested a determination that the sale of kWh pursuant to contracts with schools, governmental entities, and other non-profit entities does not constitute regulated electric service. (Application, Ex. A-1 at 1). Likewise, the application requested expedited

relief due to various federal tax incentives that are anticipated to expire at the end of 2009. *Id.* The application was based upon two executed agreements with two schools within the Scottsdale Unified School District.

At a procedural conference held on July 16, 2009, parties discussed how best to process the application in light of certain competing interests, such as SolarCity's desire to receive expedited relief as opposed to various other parties' desire to hold an evidentiary hearing to resolve the adjudication issues. Commission Utilities Division Staff ("Staff") proposed a bifurcated process in which preliminary relief could be provided by evaluating the rates set forth in the two executed agreements as special contracts rates ("Track 1") and by evaluating the status of SolarCity as a public service corporation in a second phase ("Track 2"). By procedural order, Staff's two-track process was adopted. The Commission approved the rates as special contract rates in Decision No. 71277 (September 17, 2009).

Subsequently, parties were ordered to file testimony with regard to the Track 2 issue, which is whether SolarCity is acting as a public service corporation when it provides solar energy service through an SSA or PPA to schools, governmental institutions or non-profit organizations. SolarCity filed its Direct Testimony on August 24, 2009. Staff and the other interveners provided responsive testimony on September 30, 2009. The Company filed rebuttal testimony on October 13, 2009. An evidentiary hearing was held on October 14, 15, 16, 23 and November 2, 9, 2009. Following is Staff's Initial Post-Hearing Brief on Track 2 issues.

III. DISCUSSION.

Determining whether an entity is a public service corporation requires a multi-step analysis. First, one must consider whether the entity satisfies the literal and textual definition of a public service corporation under Article 15, Section 2, of the Arizona Constitution. *Southwest Transmission Cooperative v. Ariz. Corp. Comm'n,* 213 Ariz. 427, 430, 142 P.3d 1240, 1243 (App. 2007). Second, one must evaluate the facts presented by the case in light of the eight factors discussed by the Arizona Supreme Court in *Natural Gas Serv. Co. v. Serv-Yu Coop.,* 70 Ariz. 235, 219 P.2d 324 (1950). Finally, other Arizona cases, such as *Southwest Transmission* and *Arizona Corp. Comm'n v. Nicholson*, 108 Ariz. 317, 497 P.2d 815 (1972), provide additional important guidance. This brief

will begin this inquiry with a discussion of the definition of the term "public service corporation" provided by the Arizona Constitution.

A. SolarCity is a Public Service Corporation under the Plain Language of Article XV, Section 2 of the Arizona Constitution.

Any discussion of whether an entity is a public service corporation must start with the words of the Arizona Constitution. The Arizona Constitution defines the term "public service corporation" as:

> [a]ll corporations other than municipal engaged in furnishing gas, oil, or *electricity for light, fuel, or power*; or in furnishing water for irrigation, fire protection, or other public purposes; or in furnishing, for profit, hot or cold air or steam for heating or cooling purposes; or engaged in collecting, transporting, treating, purifying and disposing of sewage through a system, for profit; or in transmitting messages or furnishing public telegraph or telephone service, and all corporations other than municipal, operating as common carriers, shall be deemed public service corporations.

Ariz. Const. art. XV, § 2 (emphasis added). By owning and operating electric generating equipment and by selling the electricity from that equipment, SolarCity qualifies as a public service corporation under the plain language of the Arizona Constitution.

1. SolarCity's System Generates Electricity.

There is no question from the evidentiary record in this case that SolarCity's operations generate electricity. SolarCity's own engineer and witness, Ben Tarbell, described in the following passage from his testimony how SolarCity's equipment generates electricity:

> Each system will consist of First Solar FS275 thin film solar modules and Satcon inverters. The solar modules will be secured to the roof using tilt up racking.
>
> Once installed on the roof, the system generates electricity when sunlight illuminates the solar modules. The illuminated solar modules produce DC electricity and are wired together in series/parallel strings to produce the required voltage and current characteristics for the inverters. The inverters take DC electricity from the solar modules and convert it to AC electricity that matches the voltage and phase of the electricity grid. The AC output of the inverter interconnects through the main service panel of the building on the customer side of the meter.

(Tarbell Dir. Test., Ex. A-4 at 1).

SolarCity witness Tarbell also described how electricity is created in the following passage from his testimony:

> Solar cells are fabricated from a thin wafer or film of semiconductor material, such as silicon. The silicon wafer is treated (or doped) to form an electric field that is positive on one side and negative on the other side. Conductive electrodes are added to both surfaces of the wafer to form a cell. As sunlight illuminates the cell, photons in the light excite or knock loose electrons from the atoms in the semiconductor. Where the energy of the photon is enough to push the electron over the "band gap" in the semiconductor, an electrical potential is formed across the cell. When the electrodes of the cell are connected to a load, a current will flow creating DC electricity. Individual cells are connected electrically in series and parallel arrangements to enable a usable voltage and power range forming a solar module. Multiple modules are connected together in an array to supply the DC input to an inverter which converts the DC energy to AC electricity.

Id. at 3.

Thus, there can be little question that electricity is being generated and that SolarCity's equipment generates the electricity. Under the SSA with the School District, SolarCity owns, designs, operates and maintains each system. (Application, Ex. A-1 at 13). Further, that electricity is no different than the electricity provided by APS or any other electric distribution company in the State of Arizona. (Irvine Dir. Test., Ex. S-1 at 31-32).

2. SolarCity "Furnishes" or "Provides" Electricity to Members of the Public.

To qualify as a public service corporation under art. XV, § 2, SolarCity must "furnish" electricity to members of the public. There was much debate at the evidentiary hearing as to whether SolarCity would be "furnishing" or providing electricity to its customers through the SSAs.

Staff's position is that the Company is "furnishing" electricity generated by equipment that it owns to the School District under the SSA. (Irvine Dir. Test., Ex. S-1 at 8). "Furnishing" is defined in Webster's Ninth New Collegiate Dictionary as "to provide with what is needed" or "the provision of any or all essentials for performing a function."

a. There is a Transfer of Possession of Electricity Generated by SolarCity to the School Districts.

The meaning of "furnish" in art. 15, § 2, was considered in *Williams v. Pipe Trades Industry Program of Arizona*, 100 Ariz. 14, 20, 409 P.2d 720, 274 (1966). In *Williams,* a company applied for a CC&N "[t]o furnish hot or cold circulating chemicals, gases or water for heating or cooling purposes." *See, Southwest Transmission*, 213 Ariz. at 431, 142 P.3d at 1244 (*citing Williams* at 16,

409 P.2d at 721). The *Southwest Transmission* Court characterized the *Williams* Court's holding as follows:

> In considering whether such conduct constituted 'furnishing water for irrigation, fire protection, or other public purposes' such conduct constituted 'furnishing water for irrigation, fire protection, or other public purposes' under Article 15, Section 2, the court noted that 'furnish' was defined as 'to provide or supply with what is needed, useful or desirable,' and concluded that the word connoted a transfer of possession. In that case the court determined that the company did not 'furnish water under Article 15, Section 2, *reasoning that the water was the means or conduit by which the heat was supplied and that no transfer of possession of the water occurred.*

Id. at 431, 142 P.3d at 1244 (emphasis added) (citations omitted).

Then in *Southwest Transmission*, the company argued that, in transmitting electricity from the generator to the distributor, there was not transfer of possession because it was acting simply as a conduit between the generators and the distributors. *Id.* The *Southwest Transmission* Court rejected this argument because, unlike *Williams*, in which the company retained possession of the water and the water was not the actual product being provided, the commodity being transferred or transmitted in that case was electricity. *Id.* The Court, therefore, found that Southwest Transmission was indeed "furnishing" electricity and was a public service corporation. *Id.*

This case is no different. SolarCity generates electricity, and ultimately, the possession of the electricity produced is transferred to the end user customer. Unlike *Williams*, SolarCity does not retain possession of the electricity, and electricity is the actual product being provided. Therefore, SolarCity is furnishing electricity pursuant to Article 15, § 2 of the Arizona Constitution.

As discussed immediately below, to suggest as SolarCity and RUCO do, that there is no transfer of possession of the electricity from SolarCity to the Districts, is inconsistent with the provisions of the contract itself and with the *Williams* case.

b. <u>The Agreements State that SolarCity is Selling Electricity and Provides for that Sale on a kWh Basis.</u>

Both the Agreements contain language that supports Staff's position that this is actually a sale of electricity. For ease of reference, Staff will use the Coronado contract:

- Purchaser *shall purchase all such electric energy* as and when produced by the System....[1]

- Purchaser's *purchase of electricity under this Agreement* does not include Environmental Attributes....[2]

- Purchaser shall be permitted to be off line for two (2) full twenty-four (24) hour days (each, a "Scheduled Outage") per calendar year during the Term, during which days Purchaser *shall not be obligated to accept or pay for electricity* from the System.[3]

- Purchaser agrees that it will make such monthly payments to Seller and that the such electricity monthly at the $/kWH rate shown in Exhibit 1 (the "Contract Price") is a fair and reasonable price in light of the benefit that the Purchaser receives under this Agreement. [4]

- Monthly Invoices. Seller shall invoice Purchaser monthly. Such monthly invoices shall state (i) the amount of electric energy produced by the System and delivered to the Delivery Point, (ii) the rates applicable to, and charges incurred by, Purchaser under this Agreement and (iii) the total amount due from Purchaser.[5]

As Staff witness Irvine testified:

> The SSAs establish a payment rate that is based on a specified rate per-kWh. Consequently, it is important to know how many kWh are produced by the panels. The Incumbent Utility's bi-directional meter measures only the amount of kWh that flows from the grid to the school, or conversely the amount of kWh that flows from the school to the grid.

(Irvine Dir. Test., Ex. S-1 at 5). Taken as a whole, the provisions of the contracts indicate that the primary purpose of the Agreement is for the sale of electricity.

Moreover, as Western Resource Advocates ("WRA") witness Berry pointed out, the SSA is a form of a purchase power agreement. Dr. Berry testified that the Lawrence Berkeley National Laboratory defines a purchased power agreement as:

> [A] third-party ownership structure in which the site host neither owns nor leases the PV system, but instead agrees to buy all of the electricity generated by the system for a specified term.

(Berry Dir. Test., Ex. WRA-1 at 3).

---

1 (*See* Application, Ex. A-1, Ex. B at 4, under the heading Monthly Charges (emphasis added)).
2 (*See id.* at 5, under the heading "Environmental Attributes and Environmental Incentives (emphasis added)).
3 (*See id.* at 8, under the heading "Environmental Attributes and Environmental Incentives" (emphasis added)).
4 (See *id.* at 4, under the heading "Billing and Payment, a. Monthly Charges".
5 (See *id.* at 5, under the heading "Monthly Invoices."

Finally, the Company is providing or furnishing electricity to the School Districts for profit. SolarCity is a for-profit company and is not in the business of furnishing its services for free or at cost.

The Commission should reject the Company's various arguments that it is not "furnishing" electricity through the SSAs, discussed below. The record in this case supports Staff's position.

3. Arguments that SolarCity Is Not Generating Electricity or Furnishing Electricity to the Public Are Not Persuasive.

a. SolarCity's Arguments that There Has Been No Transfer of Possession and Thus it Cannot Be Furnishing Electricity Under the SSA Must Fail.

In an apparent attempt to defeat Commission jurisdiction, SolarCity argues that "the customer owns all electricity the moment it is produced and therefore, there is never a transfer of possession." (Rive Rebuttal Test., Ex. A-5 at 5). In this regard, the SSAs with the School District provide that "Purchaser will take title to all electric energy that the System generates from the moment the System produces such energy..." (Desert Mt. SSA, Ex. A-2 at ¶ 4(a)).

There are several reasons why this argument must fail. First, regardless of what the contract states, there is a transfer of possession that takes place. There has to be. SolarCity, not the customer, owns the solar panels that produce the electricity. Therefore, at some point the electricity contained in SolarCity's equipment is transferred to the customer.

The energy is produced in the solar panels which SolarCity owns. (Irvine Dir. Test., Ex. S-1 at 7). As Mr. Irvine and others explained in their testimony and at the evidentiary hearing, the electricity produced moves from the photovoltaic panels to an inverter, likewise owned by the Company, where the electricity is converted from direct current (DC) to alternating current (AC). (Irvine Dir. Test., Ex. S-1 at 5; Tarbell Dir. Test., Ex. A-4 at 3). The inverter transforms the electricity into a form that would be useable for ultimate consumption by the SSA customer. (Tarbell Dir. Test., Ex. A-4 at 3). At the inverter, the Company operates a meter to measure the amount of electricity that the photovoltaic panels produce. (Tr. at 343-44). From the inverter, the electricity crosses SolarCity's wires to enter the customer's load or electrical panel and to be either consumed by the customer or transferred to the grid through net metering. (Irvine Dr. Test., Ex. S-1 at 5; Tarbell Dir. Test., Ex. A-4 at 3; Tr. at 345, 346). No matter what the contract states, the customer

does not actually receive possession of the energy until the AC power travels from the inverter to the electrical cabinet or breaker box ("electrical panel" or "customer's load center"). At that point, the energy is available for the customer's use.

Even if one could stretch the facts so as to accept the notion that SolarCity does not own the electricity that it is transferring or selling, it still has custody or possession of the electricity up until the time that it goes from the inverter to the customer's load panel.

Second, it is clear that SolarCity included this provision in its contract with the School District for the purpose of defeating Commission jurisdiction. If the Company's position is correct, there is nothing that would prevent any other utility from including such provisions in their contracts with customers to defeat Commission jurisdiction over various aspects of their business.

Third, as discussed above, the Company's own agreement states that it is selling electricity. Therefore, the Company's position that it is not a sale of electricity to the School Districts is inconsistent with the provisions of the contract itself.

b. <u>SolarCity's Argument that it is Not Furnishing Electricity Under the SSAs Because This Is Merely a Financing Arrangement Is Inconsistent With the Way it Has Structured its Agreement.</u>

To qualify for federal tax incentives, SolarCity's SSA cannot merely be a financing arrangement. The SSAs were structured to be a contract for the sale of electricity so that the transaction would qualify for significant federal tax incentives. (Irvine Dir. Test., Ex. S-1 at 14). The Solar Energy Industries Association's ("SEIA") Guide to Federal Tax Incentives for Solar Energy, Version 3.0, Released May 21, 2009 at 1.13 states:

> The key when dealing with such an entity [nonprofits] is to sign a contract merely to sell it electricity. Someone who merely buys electricity from solar equipment owned by someone else is not considered to "use" the equipment. Care should be taken to make sure the contract is not characterized by the IRS as a lease of the solar equipment in substance even though it looks in form like a power contract.

(Rive Dir. Test., Ex. A-4, Ex. B at 1.13; *see also* Tr. at 473).

Thus, it is simply incongruous to argue that the SSA was structured primarily as a financing arrangement or lease with an option to buy. Again, as the following excerpt from the SEIA Guidelines indicate, this would not be permissible under federal tax laws.

> "[U]se of the equipment by a school, municipal utility, government agency, charity or other tax-exempt organization (unless the equipment is used in a taxable side business) or in some case by an electric cooperative will rule out a credit on the equipment. This means that solar equipment cannot be leased to such an entity. A lessee 'uses' the equipment it is leasing. However, a lease with a term of less than six months does not count as a "use." The credit is calculated in the year equipment is first put into service. Ineligible use of the equipment at any time during the first five years would cause part of the tax credit claimed to be recaptured."

(Rive Dir. Test., Ex. A-4, Ex. B at 1.1.3).

c. <u>The Commission should reject RUCO's argument that jurisdiction over SolarCity would Make the Commission's Jurisdiction Dependent Upon the Financing Arrangement Used.</u>

RUCO witness Jerich argues that, if the Commission exercises jurisdiction over SolarCity, the Commission's jurisdiction in this instance would depend upon the type of financing arrangement used. (Jerich Dir. Test., Ex. RUCO-1 at 8). This is not the case. The Commission's exercise of jurisdiction is based solely upon the fact that SolarCity qualifies as a public service corporation when it provides service under an SSA. It is furnishing electric service to members of the public for a profit. Any entity that provides service in this manner would meet the Arizona Constitution's definition of public service corporation.

Several parties, including RUCO, then ask why the Commission would want to regulate entities receiving service pursuant to an SSA or PPA, but not customers which purchase their own systems. First, the interconnection and perhaps other aspects of the customer's connection would be regulated by the Commission. Second, with regard to any of the industries that the Commission regulates, the applicable constitutional definition simply does not provide for regulation of a retail customer's provision of service to him or herself. But, the constitutional definition clearly applies where another person or entity is providing an essential service to members of the public for profit. Perhaps this goes back to the common law and the notion that when an entity elects to provide an essential commodity to members of the public, it should be held to a higher standard.

d. The Service and Commodity Offered by SolarCity is an "Essential Service."

There can be little dispute that the generation of electricity is an essential service. In *Southwest Transmission*, the Court held that the transmission of electricity involved the provision of a commodity in which the public has an interest. *Southwest Transmission* at 433, 142 P.3d at 1246.

SolarCity witness Peterson, who is an official of the Scottsdale Unified School District, also argued that the District has no need for additional electricity, that it has all the electricity it needs, and that it is really just seeking a lower price for its electricity. But this misses the point. The reason the School District is able to lower its bills for electricity is because it is getting a new source of electricity from SolarCity.

Only WRA witness Berry and SolarCity witness Peterson appeared to suggest that the electricity produced by SolarCity's system was not an essential service. Dr. Berry suggested that the solar electricity supplied by SolarCity was not essential because it was not part of the "grid." (Tr. at 779). Staff does not find this argument to be persuasive. The electricity obtained by SolarCity displaces load now provided by incumbent providers. Because of this, it is certainly essential. Mr. Peterson suggested that the electricity produced by the solar panels was not essential because they could get the same electricity from APS and their sole interest was in getting lower electric rates. But, the only way that the School District is able to get the lower electric rates is because it is obtaining a new source of lower priced electricity from SolarCity.

B. The *Serv-Yu* Factor Analysis Also Supports a Finding That SolarCity Is A Public Service Corporation.

Merely meeting the textual definition of Article 15, § 2 does not establish an entity as a public service corporation. *Southwest Transmission* at 431, 142 P.3d at 1244 (*citing Southwest Gas*, 169 Ariz. at 286, 818 P.2d at 721). To be a public service corporation, a company's business and activities must implicate the public interest. *Southwest Transmission* at 432, 142 P.3d at 1245. In *Serv-Yu*, the Arizona Supreme Court set out eight factors to consider in determining whether a corporation is "clothed with a public interest."

Before undertaking a discussion of the various *Serv-Yu* factors, it is appropriate to review the posture of the *Serv-Yu* case, because its history influenced the development of the factors. The purpose of this oft-cited case was to clarify a previously issued opinion. While *Serv-Yu* provides helpful suggestions for determining whether a company is a public service corporation, the *Serv-Yu* Court did not intend for these factors to be used as a rigid test. The case merely lists these factors as facts from the original case "that should have been pointed out." *Serv-Yu*, 70 at 237, 219 P.2d at 325. In other words, *Serv-Yu* creates a list of subjects to explore; it does not create a rigid checklist.

Moreover, the eight *Serv-Yu* factors are merely guides for analysis and they need not all be found to exist before the company in question may be deemed a public service corporation. *See Petrolane-Arizona Gas Serv. v. Ariz. Corp. Comm'n*, 119 Ariz. 257, 259, 580 P.2d 718, 720 (1978). *See also Southwest Transmission* at 427, 142 P.3d at 1240 (affirming the lower court which applied the eight-factor test found in *Serv-Yu* and concluded that, although four factors might favor the position that entity was not a public service corporation, the balance of factors weighed in favor of finding that entity was a public service corporation). Finally, it is important to note that the various factors tend to overlap, as will become apparent in subsequent sections of this brief.

The *Serv-Yu* factors include the following:

(1) What the corporation actually does

(2) A dedication to public use

(3) Articles of incorporation, authorization, and purposes

(4) Dealing with the service of a commodity in which the public has been generally held to have an interest

(5) Monopolizing or intending to monopolize the territory with a public service commodity

(6) Acceptance substantially of all requests for service

(7) Service under contracts and reserving the right to discriminate is not always controlling

(8) Actual or potential competition with other corporations whose business is clothed with public interest.

Each of these factors are discussed in turn below with respect to SolarCity's operations.

1. What the corporation actually does.

According to the evidence presented, SolarCity will generate electricity using equipment that it will own and maintain, and then provide that electricity to its customers. (Irvine Dir. Test., Ex. S-1 at 9). The SSA is structured such that the customer pays for the electricity generated by the solar facilities at a per-kWh rate. (Application, Ex. A-1, Ex. B at 4; Irvine Dir. Test., Ex. S-1 at 5, 9, 18).

The evidence is undisputed that SolarCity will finance, design, construct, own, operate, and maintain the solar generating equipment. (Irvine Dir. Test., Ex. S-1 at 9). SolarCity's activities parallel those of traditional electric utilities. *See* Tr. at 718-19.

Further, from the perspective of the only witness who represents an SSA customer, the SSA is a means to reduce the amount of electricity purchased from the incumbent utility by substituting it for lower cost electricity provided by SolarCity. (Peterson Dir. Test., Ex. A-5 at 12). Although SolarCity may characterize the SSA as a financing agreement, it is more clearly intended as a vehicle for the customer to obtain lower cost electricity, by offsetting the electricity provided by the incumbent utilities with the lower cost electricity produced by SolarCity. (Irvine Dir. Test., Ex. S-1 at 21). The natural conclusion is that SolarCity will own, operate, and maintain solar generation facilities for the purpose of selling the electricity generated by those facilities to customers who use that electricity to reduce the amount purchased from the incumbent utility.

Moreover, SolarCity has deliberately structured these agreements as contracts for the sale of electricity. (Irvine Dir. Test., Ex. S-1 at 10-11, 14-16). As explained in Staff witness Irvine's prefiled testimony,

> SolarCity has explained that non-profit entities, such as schools, cannot directly benefit from tax incentives and must, therefore, make use of a third-party who can make use of the tax incentives and pass the savings on to the school district. SolarCity also explains that should the School District lease or own the solar system, it would be considered the "user" of the system by the IRS and subsequently not be eligible for tax incentives. SolarCity explains that the SSAs are designed to comply with the tax incentive requirements.

Id. at 10. Although SolarCity asserts that the agreements do not provide for the sale of electricity, this argument is belied by statements in the "Guide to Federal Tax Incentives for Solar Energy," Version 3, released by the Solar Energy Industries Association ("SEIA") and attached to SolarCity's

prefiled testimony, and by provisions in the agreements themselves. *Id.* at 14-18. These statements make it abundantly clear that an SSA is an arrangement for the sale of electricity.

When considering what the company actually does, a court also considers whether the company's actions affect so considerable a fraction of the public that it is public in the same sense in which any other may be called so. *Southwest Transmission* at 432, 142 P.3d at 1245, (*citing Serv-Yu*, 70 Ariz. at 240, 219 P.2d at 327). In SolarCity's own words, it intends to serve millions of customers and those customers will rely upon the solar electricity generated by SolarCity to the same extent that they rely upon the electricity generated by APS.

2. <u>A dedication to public use.</u>

Whether there is a dedication to public use is governed by the facts and the circumstances of each case. *Serv-Yu*, at 238, 219 P.2d at 326. Although the intent of the owner may be a relevant consideration, the outcome under this factor does not solely depend upon the wishes and declarations of the owner. *Id.* To be a public service corporation, "an owner of such a plant must at least have undertaken to actually engage in business and supply *at least some* of his commodity *to some of the public.*" *Id.* (emphasis added). Contrary to SolarCity's assertions, it is not necessary to hold oneself out as providing service to the *entire public* in order to be a public service corporation.

The company that sought to avoid regulation in *Serv-Yu* suggested that "the true criterion by which to judge of the character of the use of any plant or system alleged to be a public utility is *whether the public may enjoy it of right or by permission only . . . .*" *Id.* at 239, 219 P.2d at 327 (emphasis added). The *Serv-Yu* Court, however, rejected that specific characterization, and instead recognized that the issues are more subtle. Quoting from another court, the *Serv-Yu* Court noted that, "[t]o state that property has been devoted to public use is to state also that *the public generally, **in so far as it is feasible,** has the right to enjoy service therefrom.*" *Id.* (emphasis added). The Court also cited approvingly to the following test formulated by the Wyoming Supreme Court:

> whether or not such person holds himself out, expressly or impliedly, as engaged in the business of supplying his product or service to the public as a class *or to any limited portion of it*, as contra-distinguished from holding himself out as ready to serve *only particular individuals.*

Serv-Yu at 239, 219 P.2d at 327 (emphasis added) (quoting *Rural Elec. Co. v. State Bd. of Equalization*, 120 P.2d 741, 748 (1942).

In considering this issue in the context of a small water well's provision of service to two non-owners, the Arizona Court of Appeals stated:

> The well owners have provided water, a commodity in which the public has been held to have an interest, to Horton and White, both non-owners. However as the court stated in Arizona Corporation Comm'n v. Nicholson, 108 Ariz. 317, 320, 497 P.2d 815, 818 (1972): ...while supplying of water is usually a subject matter of utilities' service, this alone does not carry the presumption that all use of service in connection with such water is a dedication of public use. Dedication of private property to a public use is a question of intention to be shown by the circumstances in each case."

Arizona Water Co. v. Ariz. Corp. Comm'n, 161 Ariz. 389, 391, 778 P.2d 1285, 1287 (App. 1989).

The Court then went on to look at the extent that the well-owners had held their services out to members of the public.

> Aside from these two non-owners, the well owners have refused all other requests for service from the well. They have not engaged in any solicitation for customers. The Company's brief acknowledges that the question of "how many customers are necessary before an entity can be determined to be serving the public..." is "...not a matter for rigid determination." Nevertheless, the Company argues that the well owners became a public service corporation as soon as service was extended to any non-owner. *Serv-Yu* does not support such a proposition, and we decline to adopt such a rigid rule. We conclude that the well owners did not intend to dedicate their well to public use and did not monopolize or intend to monopolize water service in the area. *Serv-Yu*, 70 Ariz. at 239-40, 219 P.2d at 327.

Arizona Water Company at 392, 778 P.2d at 1287.

The issue is not whether the *entire public* has the right to demand service from SolarCity *under any circumstances*, but rather whether *some portion of the public* has the right to enjoy service, "*in so far as it is feasible.*" *See Serv-Yu* at 239, 219 P.2d at 326.[6] *See also Nicholson* at 319-20, 497 P.2d at 817-18 (rejecting the position that a company could not constitute a public service corporation unless all members of the public have an enforceable right to demand its service).

[6] This factor and the associated discussion duplicates to some extent the considerations at issue under *Serv-Yu* factor number 6, "Acceptance of Substantially All Requests for Service."

The evidence in this case shows that SolarCity intends and is holding itself out to provide solar electric service to a substantial portion of the public. This is clearly demonstrated through the testimony of SolarCity witness Rive:

> Q. (by Mr. Hains)And it (SolarCity) is a for profit entity, is that correct?
>
> A. That's the plan.
>
> Q. And more power to you in effectuation of that plan.
>
> Would it be, would it do its best to maximize the opportunity to do business resources permitting?
>
> A. Absolutely.
>
> Q. To the extent that SolarCity would be turning customers away, it would be for business purposes, not for arbitrary or discriminatory purposes?
>
> A. No. *The only reason why we turn customers away in most cases is the building cannot accommodate the solar system.*
>
> Q. And that would be, again, a business practical purpose, not for, you know, because of the characteristics of the customer?
>
> A. *No, characteristics of the building.*

(Tr. at 271 (emphasis added); *see also* Tr. at 272-74). SolarCity clearly intends to offer service to a definable subset of the public for whom it is feasible for the Company to provide service. This constitutes "a dedication to public use" under *Serv-Yu.*

In its Application, the Company states that its mission is to help millions of homeowners, community organizations and businesses adopt solar power by lowering or eliminating the up-front costs. (Application, Ex. A-1 at 2-3). The Company currently utilizes SSAs for schools, non-profit organizations and governmental entities. *Id.* at 12. But this is a large and definable segment of the public and could cover significant load over the next few years. In response to Staff Data Request 2.28, SolarCity stated:

> However, in its best estimate SolarCity anticipates the potential for a total of 20 MW in systems via SSA's in AZ over the next 2 years, 100 MW over 5 years and 1 GW over 10 years. SolarCity estimates that 50% of the SSAs will be schools (half k-12, half post-secondary), 40% governmental (state and local), 10% other non-profits. Geographically the installations will largely track population densities with a bend toward jurisdictions with higher electricity prices and/or higher incentives since the value proposition of solar is stronger.

(Irvine Dir. Test., Ex. S-1 at 9).

Moreover, Dr. Berry notes that "[a]ccording to the Interstate Renewable Energy Council (IREC), nearly all of the larger installations and many medium-size non-residential installations use purchased power agreements, and at least one company offers purchased power agreements for residential customers." (Berry Dir. Test., Ex. WRA-1 at 4) (citing Larry Sherwood, U.S. Solar Market Trends 2008, Interstate Renewable Energy Council, July 2009 at 4). So, the SSA or PPA form of providing solar service will only grow and may become a prevalent form of providing service to all customer groups. *Id.*

In summary, a corporation such as SolarCity that serves a substantial part of the public thereby makes its methods of operation a matter of public concern. *See Serv-Yu* at 242, 219 P.2d at 328.

3. Articles of Incorporation, authorization, and purposes.

SolarCity contends that, because its Articles of Incorporation do not expressly state that the Company shall operate as a public service corporation, it does not satisfy this *Serv-Yu* factor. To that end, it included the Articles of Incorporation for several incumbent electric utilities as part of its prefiled rebuttal testimony. (Rive Rebuttal Test., Ex. A-5, Ex. D). Staff acknowledges that these various articles of incorporation generally specify that these electric utilities will operate as public service corporations. However, the fact that SolarCity's Articles of Incorporation do not expressly state that it shall operate as a public service corporation does not preclude the Company from doing business as a public service corporation. (Irvine Dir. Test., Ex. S-1 at 24).

"It is what the corporation is doing rather than the purpose clause that determines whether the business has the element of public utility." *Serv-Yu* at 241, 219 P.2d at 328. Corporate statements about an entity's authorizations and functions could be made with the purpose of avoiding regulation, and should not be used to deflect attention from a determination of the true character of the business. *Id.* at 242, 219 P.2d at 328-29. Thus, various strategies, such as changing the purpose clause of a charter, refraining from use of the right of eminent domain, or avoiding a holding out to serve the public generally and selling only to select consumers by private contract, may not be successfully

adopted as means to avoid regulation. *Id.* If a business is affected with a public interest, it is a public service corporation. *Id.*

To be clear, SolarCity's Articles of Incorporation do not in any way preclude SolarCity from doing business as a public service corporation. Therefore, SolarCity cannot convincingly claim that this factor conclusively demonstrates that it is not a public service corporation.

4. Dealing with the service of a commodity in which the public has been generally held to have an interest.

"In determining the question of whether an entity is a public service corporation, much enlightenment is gained if we know that the utility is dealing with a service of a commodity in which the public has generally been held to have an interest." *Id.* at 238-39, 219 P.2d at 326. Electricity is indisputably a commodity in which the public has been generally held to have an interest. *See, e.g., Arkansas Elec. Coop. v. Arkansas Pub. Serv. Comm'n,* 461 U.S. 375, 394 (1983).

The evidence shows that SolarCity will provide electricity, and the principal objective of the SSA is to provide electric service from solar generating facilities. As such, SolarCity's SSAs deal with the sale of electricity, and electricity is a commodity in which the public has been generally held to have an interest. (Irvine Dir. Test., Ex. S-1 at 25).

SolarCity appears to imply that, because its electricity is produced by renewable generation, there is a fundamental difference between SolarCity's electricity and the electricity provided by incumbent utilities. Such an argument is misplaced, as many traditional incumbent utilities have renewable generation in their resource portfolios and the amount of renewable generation in utility portfolios will only continue to increase. *See* A.A.C. R14-2-1804. In any event, the testimony of Mr. Peterson on behalf of SolarCity supports the conclusion that the School District views SolarCity's kWh as interchangeable with the incumbents' kWh, as the School District's goal is to purchase electricity at a lower rate relative to the rates offered by the incumbent utilities. (Tr. at 533-34, 538, 543, 561, 563-64, 565).

Under the SSAs as proposed by SolarCity, the Company will own and maintain generation facilities and will sell electricity generated therefrom. Clearly, this is the provision of electricity.

WRA witness Berry suggested that electricity in the abstract is not a service in which the public has an interest. The public would only have an interest if it is provided through a network if generation transmission and distribution facilities. *Id.* at 778.

But, the suggestion that only electricity provided through a centralized generation facility connected to transmission facilities is a matter of public interest is simply too narrow and rigid an interpretation of the public's interest. As discussed, it would exempt distributed generation no matter how large in scale it ultimately became simply because it was decentralized and did not tie into the transmission network. This also ignores the net metering aspect of distributed generation and the fact that excess electrons are pushed back onto the public network or grid for consumption by other customers.

5. Monopolizing or intending to monopolize the territory with a public service commodity.

Throughout the hearing, SolarCity and other parties seemed to place an inordinate degree of reliance upon their belief that, because SolarCity is not likely to become a monopoly, the Commission should conclude that it is not a public service corporation. *See, e.g.,* Tr. at 103, 218-19, 888. Although there may have been a time when a monopoly market structure was a hallmark of public utility status, that time has long passed. Examples of public service corporations that operate in a market that is either competitive or transitioning to competition abound in the telecommunications industry. And the Commission's attempts (although now apparently aborted at least for the present) to restructure the Arizona electric industry assumed eventual competition among *regulated public service corporations*. *See, e.g.,* A.A.C. R14-2-1601, -1603, -1605.

In *Mountain States Telephone & Telegraph Co. v. Arizona Corp. Comm'n,* 132 Ariz. 109, 113, 644 P.2d 263, 267 (App. 1982), the Company argued that the Commission's regulatory jurisdiction is predicated solely upon the monopolistic structure for providing the service regulated. If the monopoly disappears, the Company argued, regulation must disappear too. *Id.* at 113, 644 P.2d at 267. The court, however, disagreed, stating that the power to regulate public service corporations is derived from their status as corporations performing a public service, not from any monopoly status. *Id.* at 114-15, 644 P.2d at 268-69. The court noted that this conclusion is consistent with the

many cases that hold that it is the public character of the service rendered by the corporation that allows the Commission to exercise jurisdiction over it. *Id.* at 115, 644 P.2d at 269. The existence of a monopoly does not play a part in that determination. *Id.*

Furthermore, SolarCity has an expressed desire to do as much business as possible and so a monopoly—at least among the most lucrative customers—is a potential. The *Serv-Yu* Court implicitly recognized that the potential of a competitor to attract the most desirable customers (sometimes referred to as "cherry-picking")[7] is a factor that may weigh in favor of determining that a competitor is a public service corporation. *See Serv-Yu* at 242 , 219 P.2d at 328-29 (noting that public service corporation status was appropriate in light of Company's intent to monopolize the "lucrative business").

At times during the hearing, it was suggested that SolarCity is not a public service corporation because its obligation to serve is not identical to that of a traditional electric utility. (Tr. at 218-20, 333-35. 938). This argument assumes that the standard under *Serv-Yu* is whether the *entire public* has the right to demand service from SolarCity *under any circumstances*, instead of whether *some portion of the public* has the right to enjoy service, "*in so far as it is feasible.*" This argument also assumes that a utility's duties under its "obligation to serve" are always identical to the duties of a "provider of last resort." Staff respectfully suggests that this is not the case.

For a *monopoly* utility, the "obligation to serve" and the "provider of last resort" obligation are co-extensive for obvious reasons. The nature of public utility service requires that there be a designated provider of last resort in order to ensure continuous and reliable service to the public. If there is only one utility providing service in any given area, then that monopoly utility becomes the provider of last resort and, of necessity, that utility's obligation to serve and its obligations as a provider of last resort are practically indistinguishable. With the advent of competition and the entrance of alternative providers, however, the landscape becomes more complicated.

Efforts to restructure both the telecommunications industry and the electric industry have included specific means to designate "providers of last resort" in order to ensure that the public will continue to have utility service. A.R.S. § 40-202; A.A.C. R14-2- 1601; *see,* also, 46 U.S.C. § 214,

[7] *See also* RUCO's Pre-filed Test. Of Stephen Ahearn, July 3 2007 in Docket No. E-03964A-06-0168 at 4.

applicable to telecommunications providers. All the parties to this case, including the incumbent utilities, appear to assume that the incumbent utilities, rather than SolarCity, will operate as the providers of last resort. (Tr. at 978).

Staff is not suggesting that SolarCity should be designated as a provider of last resort, nor is Staff suggesting that SolarCity's obligation to serve should be identical to that of a provider of last resort. Nonetheless, the fact that SolarCity would not be a provider of last resort does not mean that it is not a public service corporation. If this were the test, many telecommunications carriers would not be public service corporations. In addition, if retail electric competition were ever to be revived, numerous electric service providers would similarly not be public service corporations.

6. Acceptance of substantially all requests for service.

It is not a controlling factor that the corporation supplying service does not hold itself out to serve the public generally. It has been held that a business may be "so far affected with a public interest that it is subject to regulation . . . even though the public does not have the right to demand and receive service." *Serv-Yu* at 242, 219 P.2d at 328. Regardless of the right of the public to demand and receive service in a particular instance, the question whether a business enterprise constitutes a public utility is determined by the nature of its operations. *Id.* Each case must stand upon the facts peculiar to it. *Id.*

SolarCity argues that, because it does not believe that it is obligated to meet every request for service, it is not a public service corporation. The *Serv-Yu* case, however, recognizes that public service corporations are not necessarily required to serve the public generally:

> Under the issues made in this case we were not called upon to and did not decide that appellee should or could by any order or statute be required to serve the public generally. What we did and now decide is that appellee *Serv-Yu Cooperative, Inc.*, is a public service corporation, subject to the jurisdiction and regulation of the Corporation Commission.

Id. at 243, 219 P.2d at 329. SolarCity does not intend to turn away customers whom it is feasible for SolarCity to serve. (Tr. at 271). It is clear from the evidence that SolarCity intends to serve an identifiable subset of the public (those who meet the criteria listed by Mr. Rive in his testimony, (Rive Dir. Test., Ex. A-4 at ¶ 23) and not limit its service to particular individuals. These factors support the conclusion that SolarCity is a public service corporation.

7. Service under contracts and reserving the right to discriminate are not always controlling.

SolarCity's provision of service pursuant to contract does not preclude the conclusion that SolarCity is a PSC. Entering into private contracts is not a controlling factor. If entering into contracts with customers would control the determination of whether an entity is a public service corporation, that would be an easy way of evading the law. *Serv-Yu* at 240, 219 P.2d at 327.

8. Actual or potential competition with other corporations whose business is clothed in the public interest.

Provision of electric service under the SolarCity SSAs will place SolarCity in direct competition with the incumbent electric utilities. A corporation, calculated to compete with public utilities and take business away from them, should be under like regulatory restriction if effective governmental supervision is to be maintained. *Id.* at 241, 219 P.2d at 328. Actual or potential competition with other corporations whose business is clothed with a public interest is a factor that must be considered; otherwise, corporations could be organized to operate in competition with bona fide utilities, thereby isolating portions of the public network from public regulation and oversight. *Id.*

C. Other cases also provide guidance as to whether an entity is a public service corporation.

1. *Nicholson* permits a consideration of whether providing utility service is incidental to another business purpose.

The lynchpin of the analysis in *Nicholson* was whether the provision of utility service was incidental to another business goal. SolarCity argues that an SSA agreement is a financing. (Application, Ex. A-1 at 13; Tr. at 168; Rive Dir. Test., Ex. A-4 at Q.9, 10). Staff simply disagrees. Because the SSA expressly provides for the production of electricity and for the sale of electricity, "furnishing electricity" is not incidental to SolarCity's business. It is, instead, the very purpose of SolarCity's business. Accordingly, SolarCity cannot use *Nicholson* as a means to avoid its "public service corporation" status.

2. Distributed Generation is an important link in the overall provision of electric service, and it is integral and essential to public service.

SolarCity argues that its solar generators will not be connected to the public network and that its various systems will provide only isolated service for individual customers. (Application, Ex. A-1 at 12, 14). It further argues that this degree of separation justifies the conclusion that its service is not a matter of public concern. This view of SolarCity's electric service, however, is unreasonably narrow and does not consider the inter-related nature of SolarCity's electric service as a whole or the reliability issues for the overall electric grid.

Staff disagrees with SolarCity's assertion that its system will not be connected to a "public network." Although the facilities that make up the electric grid are, for the most part, privately owned, the entire interconnected grid, its integrity, and its reliability are matters of public concern. For example, APS, TEP, and other incumbents privately own generation, transmission and distribution facilities, but these facilities are all imbued with a public character. In a similar fashion, end-use customers own certain facilities, just as SolarCity will own its solar generation equipment and associated facilities; these privately owned facilities are similarly imbued with a public character because they are all interconnected with the electric grid. Even in isolation, these facilities each have an impact upon the overall operation and reliability of the grid.

SolarCity appears to believe that there is some sort of bright line (in a jurisdictional sense) between the incumbents' facilities, which it acknowledges are regulated, and the customers' facilities, which it contends are not. *See id.* at 12. Staff, however, believes that this characterization is both oversimplified and imprecise. Both a customer's interconnected facilities and a customer's transaction with the incumbent are subject to the Commission's jurisdiction and, in fact, are within the Commission's regulatory purview. The obvious examples are the various conditions of service that the Commission imposes and that *a customer must satisfy* in order to receive utility service. *See, e.g.,* A.A.C. R14-2-203(A), -203(C), -208(B). The idea that the customer's facilities are somehow not a matter of public interest or not subject to Commission oversight is inconsistent with established regulatory practice. A customer's facilities implicate the public interest because of the overall interconnectedness of the electric grid, among other reasons.

SolarCity's view of the customer's facilities as being somehow unrelated to the overall public interest inherent in the electric grid is not persuasive. Equally unpersuasive are SolarCity's contentions that its service is isolated from the electric grid and unimportant to the public interest. SolarCity's electricity will be provided not only to the schools but also to the electric grid through net metering. (Tr. at 368). SolarCity will serve a portion of Arizona's electric load through its SSAs; however, it will also indirectly serve others as a result of net metering. That SolarCity's facilities will impact not only the overall grid but also electric service to the entire public is obvious.

If SolarCity's view were correct, one might conclude that generation service in general should be unregulated because generation could be viewed as severable from the electric system, if considered in isolation. One could also view transmission service as similarly separate, as was argued by Southwest transmission Cooperative in *Southwest Transmission*. The importance of viewing an entity's role within the entire context of the electric system is illustrated by that case.

There, a rural electric transmission cooperative sought to avoid the Commission's jurisdiction, alleging that "the nature of its business operations and its corporate structure" compelled the conclusion that it was not a public service corporation. *Id.* at 428, 142 P.3d at 1241. As a rural electric transmission cooperative, the Company provided or contracted to provide "only wholesale transmission service between the electric generator and electric distribution cooperatives," and it did "not provide retail service or transmit electricity for direct consumption by end users." *Southwest Transmission,* 213 Ariz. at 428, 142 P.3d at 1241.

The Company urged the court to consider a narrow view of the *Serv-Yu* factors. Specifically, it argued that it merely supplied "transmission service at wholesale by private contract." *Southwest Transmission, id.* 213 Ariz. at 432, 142 P.3d at 1245. Southwest further argued that it had "not dedicated its business to public use" because it did "not provide service to the public" and had "never made any offers to serve retail customers." *Id.* at 432-33, 142 P.3d at 1245-46. The court, however, concluded that it was appropriate to consider Southwest's broad role in the provision of electricity to consumers. *Id.* at 432-33, 142 P.3d at 1245-46.

In concluding that the SWTC is a public service corporation, the court noted that,

> [i]n transmitting electricity for ultimate use by consumers, SWTC engages in a service "indispensable to large segments of our population" and is a company "clothed with a public interest." This is no less true because SWTC is one step removed from providing electricity to the consumer directly; SWTC provides and transmits a commodity in which the public has a vital interest.

Id. at 433, 142 P.3d at 1246 (citations omitted). The court also noted that, "[i]n supplying its transmission service, SWTC delivers to its distributors the electricity on which thousands of retail customers rely." *Id.* at 432, 142 P.3d at 1245. Over time, SolarCity's provision of electricity will be no less integral to the public interest.

Interestingly enough, some parties to this case appear to agree that SSA arrangements would be subject to Commission regulation if provided by a traditional electric utility. (Jerich Dir. Test., Ex. RUCO-1 at 14). One witness, using Arizona Public Service Company ("APS") as an example, stated as follows:

> APS as a regulated utility and as a monopoly, has an obligation to serve those customers [customers taking SSA service], whether it be by a distributed generation unit or through a transmission firm, a larger generation facility, whether it be renewable energy or carbon based. You cannot escape that obligation.

(Tr. at 913; *see also* Tr. at 695-96). These views strongly support the conclusion that the generation of electricity and sale of kWh through distributed applications is a service imbued with a public character. Furthermore, the idea that an SSA arrangement provided by SolarCity would not be regulated, but that an SSA arrangement provided by an incumbent would be regulated, would appear to be inconsistent with Arizona law:

> [T]he fact that a business or enterprise is, generally speaking, a public utility does not make every service performed or rendered by those owning or operating it a public service, with its consequent duties and burdens, but they may act in a private capacity as distinguished from their public capacity, and in so doing are subject to the same rules as any other private person so acting.

Mountain States, 132 Ariz. at 115, 644 P.2d at 269 (quoting *City of Phoenix v. Kasun,* 54 Ariz. 470, 476, 97 P.2d 210, 213 (1939)).

D. An Appropriate Degree Of Regulation Could Be Balanced With The Competitive Nature Of The SSA Provider Industry.

Staff believes that the facts and the law demonstrate that SolarCity is a public service corporation under the facts presented by this case. Staff also believes that regulation need not be structured in a way that becomes burdensome or that prevents the growth of this industry. Notwithstanding Staff's view that appropriate regulation could be structured so as to be light-handed, the degree to which regulation allegedly inconveniences an industry is not a sound basis to determine whether an entity is a public service corporation.

Because the Company did not apply for a Certificate of Convenience and Necessity ("CC&N") in the alternative, Staff did not evaluate whether the Commission should grant SolarCity a CC&N in this proceeding and did not evaluate the specific regulatory oversight that would be reasonable in these circumstances, if the Commission were to determine that SolarCity is a public service corporation. Instead, Staff has identified, in a general way, certain features that may be appropriate in a light-handed regulatory regime.

Some parties apparently argue that "regulation lite" is either impossible or unlawful. (Tr. at 216-17, 389-90, 450-51, 823, 832). These assertions are undermined by the Commission's regulation of the telecommunications industry, a competitive industry that the Commission successfully regulates under rules and principles that are uniquely appropriate for that industry. Although the telecommunications model for regulation provides a helpful starting point, Staff is not suggesting that it should be adopted as a carbon-copy model for this industry.

Based upon the record in this case, Staff's recommendation is that only "lite" regulation is necessary at this time. By "lite" regulation, Staff would envision the following streamlined process: 1) registration (a streamlined CC&N), 2) the filing of PPAs or SSAs with the Commission Staff, 3) the filing of annual reports, and 4) SolarCity being subject to the Commission's complaint jurisdiciton. Staff believes that this "lite" form of regulation would not be burdensome to SolarCity yet should allow the Commission to oversee the development of this nascent industry.

E. There are benefits to regulating the specific kind of electric service proposed by SolarCity.

Some parties have argued that Staff has not articulated a purpose for regulating SSA providers. *Id.* at 976-80. In this hearing, SolarCity and some other parties have focused upon the assertion that SolarCity will not be able to achieve monopoly status and then have argued that, in the absence of a monopoly, there is no purpose served by regulation. *Id.* at 54, 81-82, 103-04, 218, 880. However, there are goals and purposes to regulation beyond the setting of monopoly rates. *See, e.g., Ariz. Corp. Comm'n v. ex rel. Woods*, 171 Ariz. 286, 830 P.2d 807 (1992).

SolarCity's arguments appear to overlook the public interest nature of the inquiry directed by *Serv-Yu* and related cases. Specifically, factors in these cases tend to generally focus on a consideration of whether an entity is providing a public service and whether the public is uniquely interested in the service. In this case, the evidence shows that SolarCity will be providing electricity; it will do so to a definable segment of the public, not just to a few individuals; its services have the potential to be offered to a variety of customer classes; its facilities will be connected to the overall electric grid. *Id.* at 167, 176, 329-331, 368. In light of this evidence, the public nature of the service to be provided and the public's corresponding interest therein should be obvious. However, there are also additional considerations that may be less obvious, but that nonetheless deserve attention.

1. SSA customers have an interest in receiving adequate and reliable electric service from SSA providers such as SolarCity.

Every public service corporation has an obligation to provide adequate and reliable service to its customers. *See, e.g.,* A.R.S. § 40-321. The Commission, through its regulatory jurisdiction, has the ability to enforce that obligation. *See* Ariz. Const. art. XV, § 16, 19; A.R.S. §§ 40-424, -425. The existence of this enforceable obligation is one of the distinguishing features of public service, in that entities engaged in a merely private service may choose to discontinue operations (in essence, breach a contract with a customer and suffer any associated contract damages), while a public service corporation may not discontinue operations without Commission authorization. *See, e.g.,* A.R.S. § 40-285.

The testimony at the hearing illustrates the public interest implications of these principles. On behalf of SolarCity, Mr. Rive testified that the SSA customer is "protected" in the event that the solar generator fails to operate effectively because SolarCity charges on a per-kWh basis. (Tr. at 260-61). In other words, if the system fails to produce electricity, the customer is not charged. Although this SSA provision apparently ensures that a customer need not pay for electricity that has not been generated, this feature does not reproduce the protections of regulation, wherein the utility is subject to an enforceable obligation to provide adequate and reliable service.

Imagine the implications if a traditional utility could escape its obligation to provide reliable and adequate service and could instead merely forego charging customers in the event of a service failure. SolarCity will argue that its service is not indispensable and that the SSA customers will be able to substitute kWh generated by the incumbent in the event of a SSA system failure. But the consequences of an SSA system failure are nonetheless significant. As Staff witness Irvine pointed out,

> [t]here was presumably a period of time when the world lived without distributed generation and the incumbent utilities could provide absent distributed generation. But I would want to point out again for the record that in the macro sense, and I would like to go back to the example where a school enters into an SSA and has an expectation for receiving energy at a given price for a long period of time and then makes financial decisions based on that expectation, I think in that area, there is a very real need for that service once the contract is entered into, especially if you ask that teacher who gets let go because suddenly the school couldn't afford them because they could no longer get the SSA cost energy if the SSA provider stopped providing.

Id. at 1243-44. The enforceable obligation to provide the service undertaken (in this case, electric service) in a reasonable and adequate manner is appropriate in the circumstances presented by this case, in which the Company proposes to offer its services to the public and to interconnect with the overall electric grid.

2. <u>The public generally has an interest in SolarCity's provision of reliable and adequate electric service.</u>

Even those who are not customers of SolarCity (or similar providers) will be impacted by the provision of electric service through SSAs. Although SolarCity appears to be a responsible company, there is no guarantee that every similar provider will be equally reliable. And if SSA providers are

unregulated, there will be no enforceable obligation for them to provide adequate service. This situation creates the potential to increase costs that may ultimately be borne by the incumbents' ratepayers.

For example, SolarCity and others would contend that the incumbent is responsible for delivering power to the customer if the solar generating system is not producing electricity. *Id.* at 709. This would appear to be the case regardless of the cause of the lack of production. Naturally, one can expect (and plan for) certain times when solar panels will not generate electricity, such as a cloudy day. But more troubling are the possibilities wherein the solar facilities do not function properly.

Consider the circumstances wherein a solar facility is installed, the incumbent plans its resource acquisitions in reliance on the operation of that facility, yet the facility fails to operate as anticipated, perhaps repeatedly or over an extended period. In such a circumstance, the incumbent would be responsible for providing the back-up power, and the incumbents' ratepayers are apparently the ones who will bear those costs. *Id.* at 709.

The existence of SSA providers will also require the incumbents to undertake certain specific planning activities in order to ensure the reliability of the grid. *Id.* at 710; Lockwood Dir. Test., Ex. APS-1 at 10-13. These costs are also anticipated to be borne by the incumbents' ratepayers. *Id.* Finally, the unchecked growth of SSAs could present challenges to the incumbents from a forecasting perspective. *Id.* at 706-09. As the testimony of Mr. Irvine illustrated, long- term forecasting for SSA resource development would benefit the public:

> [W]ere the Commission to regulate the SSA providers, they will have the ability to require information of them so that they can learn about how much load they are serving and how much load they plan to serve, and what is the next big contract they can provide so that they can pass that information on to the incumbent utility providers so that they can do good resource planning and mitigate stranded costs from the beginning.

Id. at 1135. In the absence of regulation over the industry, the Commission has limited means to require SSA providers to provide forecasting and other information. *Id.* at 711. As has been discussed by various parties, in an unregulated setting, the only means that the Commission has to

obtain such information is through the incumbent's interconnection agreement. *Id.* This sort of vehicle is imperfect, since it is indirect.

Some parties may suggest that the Commission can monitor the proliferation of SSA systems through the various REST implementation plans used by incumbent utilities. *See, e.g.,* Tr. at 929. Such an argument does not account for the real potential that continued improvements within the solar industry will eventually make SSA projects financially viable without the need for REST rebates. Mr. Irvine explained that,

> [I]n my testimony I have described that the Commission will have some control of the proliferation of SSAs through its approval of REST tariffs. And I would point out that while that's true today, given the current economics of things, it may not be true in the future. And at some point when there is price parity between SSA electricity and grid energy, that process can be a lot more uncontrolled in the future or outside.

Id. at 1026. The point at which electricity produced through SSA arrangements reaches price parity with electricity generated by incumbent utilities may be, in a relative sense, close at hand. *See* Tr. at 706-08.

In summary, there are ratemaking considerations for incumbent utilities that are more efficiently managed by regulation of the entire electric industry, including SSA providers. One may argue that these issues should be reserved for the incumbent utilities' rate cases. *Id.* at 1025. However, the practical effect of such an approach may well be higher rates for the incumbents' ratepayers than would otherwise be necessary. If the costs to the incumbent that are caused by SSA providers can be mitigated (through imposing an enforceable obligation to provide a reasonable and adequate level of service and through reporting requirements), such steps are surely worth pursuing. The ability to regulate from the SSA side of the equation would contribute to a balanced resolution of these issues by allowing the Commission to directly address the potential causes of these underlying costs. *Id.* at 1025.

3. Regulating service provided pursuant to SSA arrangements will enable the Commission to monitor the developing market in order to promote a level playing field among the various competitors.

This proceeding has seen much attention focused upon the justifications for regulating a monopoly market; however, many parties have overlooked the corresponding justifications for

regulating a transitioning market. If the goal is to develop a market with many competitors, a market that is transitioning to competition justifies regulatory oversight. It is highly conceivable that competition with incumbent utilities for SSA service could produce an unbalanced market. As Staff witness Irvine testified,

> [T]here is a danger that [the incumbent utility or its affiliate] might exert some undue market influence by the nature of their staying power in the market, their relationships with customers, their knowledge of the customer base. And we think that there is benefits [sic] to SSA providers themselves in the Commission having a hand in that process by virtue of regulating the SSA providers, which could include the regulated affiliates of the incumbent utilities.

Id. at 977. Mr. Irvine further explained that regulation levels the playing field between new market entrants and incumbent utilities.

As a result of the incumbents' market power, one could end up with a deregulated service (SSA arrangements) and only a handful of providers (the incumbents and/or their affiliates). In other words, the industry could experience a progression beginning with the deregulation of SSA arrangements; continuing with the entrance into the market of a variety of different types of SSA providers, including incumbents, their affiliates, and providers similar to SolarCity; and resulting with the eventual exit of all providers except the incumbents or their affiliates. Recognizing Commission jurisdiction over SSA arrangements will allow the Commission to continue to exercise appropriate regulation over Arizona's electric industry in general and to develop an appropriate level of regulation for SSA arrangements in particular. *Id.* at 976. Regulation of SSA arrangements could prove instrumental to ensuring the development of this segment of the industry in a manner that is consistent with the public interest.

Some parties may argue that it is unnecessary to regulate the SSA providers in order to address the market power issues related to the incumbents. They may further claim that, because the Commission already has jurisdiction over the incumbents, the Commission may address the market power concerns without any need for additional oversight of the SSA segment of the electric industry. However, the regulation (or lack thereof) of SSA arrangements provided by others (such as SolarCity) could affect the degree to which the Commission may regulate the incumbent's provision of similar services. *See Mountain* States, 132 Ariz. at 115, 644 P.2d at 269. It is possible that the

Commission's ability to regulate the incumbent in these similar endeavors would become more circumscribed.

4. Regulation of SSA providers could create health and safety benefits.

It is too early to conclude that the Commission need not be concerned about safety issues. Although adequate safety measures are apparently in place today, the health and safety issues associated with the proliferation of distributed generation will continue to evolve as more systems are developed. (Tr. at 719).

> Q. (by Mr. Robertson) Am I correct in my understanding from this portion of your testimony that APS believes it would be able to continue to satisfactorily address these safety concerns if the projected number of SSAs which are set forth on page 8 should in fact materialize?
>
> A. (by Ms. Lockwood) We certainly believe that there are numerous requirements in place today that are designed to exactly do that. If we were to have a solar system on every rooftop, on every customer, I can't tell you whether or not the existing requirements are adequate. But I do believe that the organizations that produce those, those rules are continuously looking at that for that very reason.

Id. at 660-61. There may be issues implicated by the proliferation of SSA providers of which the Commission is not yet aware. *Id.* at 720-21.

If SSA providers were to fall outside of the Commission's jurisdiction, the only direct means at the Commission's disposal to affect their operations would be the interconnection agreements between the SSA providers and the incumbent utilities. If unforeseen issues arise that raise health and safety concerns, the Commission would have no direct means to pursue the SSA providers. *Id.* at 979, 1084, 1123.

5. Regulating SSA providers makes possible consumer service benefits.

Finding that SSA providers are subject to Commission jurisdiction would also make it possible for the Commission's Consumer Services Section to assist SSA customers with complaint issues. As Mr. Irvine noted, the Commission's Consumer Services Section is a useful intermediary for mitigating disputed issues between a utility and its customers. *Id.* at 979. If SolarCity's SSA arrangements were to fall outside the Commission's jurisdiction, this avenue would be foreclosed to customers. And similarly foreclosed would be the opportunity for a customer to pursue a formal complaint against an SSA provider.

Some parties have suggested that potential SSA customers are sophisticated and therefore would not benefit from the Commission's Consumer Services Section or from the Commission's jurisdiction over formal complaints. (Jerich Dir. Test., Ex. RUCO-1 at 10-13; Tr. at 539, 570, 755). While that may arguably be true for some customers, such as schools, governmental entities, and certain business entities, the testimony has clearly established that SSAs could be used for residential and small business customers as well. (Tr. at 234, 444, 458-59. (Fox Dir. Test., SunPower-2 at 4). Staff is concerned that the typical residential customer may not have the same degree of sophistication that the Scottsdale Unified School District demonstrated in this case, nor may these smaller customers have easy access to professional analytical resources. (Tr. at 981). Consequently, reliance on the sophistication of the customer is not reasonable.

Finally, some parties have indicated that the court system will be available to resolve potential disputes between SSA providers and their customers. (*See* Jerich Dir. Test., Ex. RUCO-1 at 10). RUCO, for example, notes that the Arizona Consumer Fraud Act (A.R.S. § 44-1522) provides both a private cause of action and an opportunity for the Attorney General to bring an action on the consumer's behalf. There are a variety of issues associated with such a contention. First, RUCO apparently assumes that the most frequent disputes between SSA providers and their customers will relate to allegations of fraud. More concerning is the implication that initiating litigation in Superior Court is as convenient for a customer as resort to the Commission's Consumer Services Section or even the Commission's formal complaint process. *See* Tr. at 918-919.

To the contrary, the Commission's Consumer Services Section is easily accessible to customers. By mediating disputes, the Consumer Services Section can often resolve matters before they rise to the level of a formal complaint.

> And it is a benefit for both the customers and the utilities themselves because they provide a forum that is a third-party forum, and they deal with a lot of questions before they rise to the level of a complaint or something that's more critical.

Id. at 979. Some customers might forego pursuing their disputes against utilities if their only avenue of relief were the courts.

F. The Extent And Effect Of A Commission Order In This Matter.

During the hearing, questions arose about the ultimate effect of any Commission order in this matter. In its Application, SolarCity asks the Commission to find that entities that enter SSA arrangements *with schools, governmental entities, and non-profit entities* are not public service corporations. Some parties, however, have urged the Commission to adopt a broader approach and to find that SSA arrangements should never fall within the Commission's jurisdiction. In that circumstance, entities that enter SSA arrangements with *residential customers or for-profit customers* would not be public service corporations. In other words, the class of the customer would not affect the determination of whether an entity is a public service corporation.

The *adjudicative* effect of any Commission order in this matter should probably be limited to the facts before the Commission and the relief requested by the Application. However, the *persuasive* effect of any resulting Commission order will likely be more significant. Staff is aware that industry stakeholders and the public often monitor Commission orders to evaluate their predictive value. The extent to which customer class is relevant (or irrelevant) to determining SolarCity's status in this matter (and the extent to which this issue is addressed in the Commission's order) may have an impact upon future cases, or may even limit the necessity for additional cases. Thus, although the Commission's order in this matter will likely be limited to resolving SolarCity's Application, its implications may be far-reaching.

IV. CONCLUSION.

For all of the above-stated reasons, Staff believes that SolarCity acts as a public service corporation under the definition provided by the Arizona constitution and the relevant case law when it provides electric service to customers under a Solar Services Agreement.

RESPECTFULLY SUBMITTED this 15th day of December, 2009.

Charles H. Hains, Staff Counsel
Maureen A. Scott, Senior Staff Counsel
Janet Wagner, Assistant Chief Counsel
Arizona Corporation Commission
Legal Division
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

The Original and 13 copies of the foregoing were filed this 15th day of December, 2009, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

A copy of the foregoing was mailed this day of 15th of December, 2009:

Jordan R. Rose
Court S. Rich
M. Ryan Hurley
ROSE LAW GROUP, P.C.
6613 North Scottsdale Road, Suite 200
Scottsdale, Arizona 85250

Daniel W. Pozefsky
Chief Counsel
RESIDENTIAL UTILITY CONSUMER OFFICE
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

Kenneth C. Sundlof, Jr.
JENNINGS, STROUSS & SALMON, P.L.C.
The Collier Center, 11th floor
201 East Washington Street
Phoenix, Arizona 85004-2385

Kelly J. Barr
SALT RIVER PROJECT AGRICULTURAL
IMPROVEMENT & POWER DISTRICT
Regulatory Affairs & Contracts, PAB 221
Post Office Box 52025
Phoenix, Arizona 85072-2025

Kenneth R. Saline
K.R. SALINE & ASSOCIATES, PLC
160 North Pasadena, Suite 101
Mesa, Arizona 85201-06764

Michael A. Curtis
William P. Sullivan
Larry K. Udall
CURTIS, GOODWIN, SULLIVAN,
UDALL & SCHWAB, PLC
501 East Thomas Road
Phoenix, Arizona 85012-3205

Michael Patten
ROSKA DeWULF & PATTEN, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Philip Dion
UNISOURCE ENERGY CORPORATION
One South Church Avenue, Suite 200
Tucson, Arizona 85701-1623

Deborah Scott
PINNACLE WEST CAPITAL CORPORATION
400 North 5th Street
P.O. Box 53999, MS 8695
Phoenix, Arizona 85072

C. Webb Crockett
Patrick Black
FENNEMORE CRAIG
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913

Bradley Carroll
SNELL & WILMER
One Arizona Center
400 East Van Buren Street
Phoenix, Arizona 85004-2202

Lawrence Robertson, Jr.
2247 East Frontage Road, Suite 1
P.O. Box 1448
Tubac, Arizona 85646

Timothy Hogan, Esq.
Arizona Center for the Law
In the Public Interest
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004

Jay Moyes
Steve Wene
Jeffrey T. Murray
MOYES SELLERS & SIMS, LTD
1850 North Central Avenue, Suite 1100
Phoenix, Arizona 85004

David Berry
Western Resource Advocates
P.O. Box 1064
Scottsdale, Arizona 85252-1064

Gerry DaRosa
BRYAN CAVE LLP
Two North Central Avenue, Suite 2200
Phoenix, Arizona 85004-4406